



MASS. R.I. 97-4

# Sales and Use Tax DOR Directive 97-4

GOVERNMENT  
COLLECTOR  
Massachusetts  
Department of  
Revenue  
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## Sales and Use Tax on Motor Vehicle Leases

### Introduction:

This Directive clarifies the application of the sales and use tax statutes, G.L. c. 64H and G.L. c. 64I, and the Department's sales tax regulation on Motor Vehicles, 830 CMR 64H.25.1, to motor vehicle leases.

In many motor vehicle leasing transactions, the retail customer negotiates the terms and executes the lease contract with a dealer. The dealer then sells the vehicle and assigns the executed lease contract to a financing corporation, which may be a subsidiary of the manufacturer. The financing corporation subsequently collects the balance of the lease payments due under the contract.

Cash down payments, trade-ins of other vehicles, and manufacturer's rebates paid to the dealer at the time the lease is signed are often referred to as "Capitalized Cost Reductions," as they decrease the amount of the monthly payments due from the lessee during the term of the lease.

### 1. Capitalized Cost Reductions on Motor Vehicle Leases: Cash Down Payments, Trade-ins, and Manufacturer's Rebates

#### Issue 1(a):

When a retail customer makes a cash down payment on a motor vehicle lease to a dealer in Massachusetts, is that payment subject to Massachusetts sales tax and, if so, who is responsible for collecting and remitting the tax?

#### Directive 1(a):

A cash down payment on a motor vehicle lease made by a retail customer to a dealer in Massachusetts is part of the sales price subject to tax. The dealer is responsible for collecting and remitting sales tax on this payment with Form ST-9 or ST-7R.

#### Issue 1(b):

If a retail customer trades in a motor vehicle to a dealer and receives credit on a motor vehicle lease, is the amount of the credit attributable to the trade-in part of the sales price subject to tax and, if so, who is responsible for collecting and remitting the tax?

#### Directive 1(b):

A trade-in credit on a motor vehicle lease, either as a Capitalized Cost Reduction or otherwise applied toward payments due under the lease, is not part of the sales price subject to tax if all of the following criteria are met:

- (1) the dealer holds a valid Massachusetts Vendor's Registration Certificate,
- (2) the dealer entered into the transaction in the regular course of business,

(3) the lessee previously paid tax on the vehicle traded-in or was exempt from tax on the vehicle traded-in, and

(4) the vehicle traded-in was titled to the lessee.

The amount of a trade-in credit is generally the value of the vehicle traded in less any debt encumbering that vehicle. If all of the above criteria are not met, the amount of a trade-in credit is part of the sales price subject to tax in accordance with the provisions of 830 CMR 64H.25.1 and Directive 97-4.

#### Issue 1(c):

When a manufacturer's rebate is paid on a leased vehicle, is the amount of the rebate subject to tax and, if so, who is responsible for collecting and remitting the tax?

#### Directive 1(c):

In Massachusetts, a rebate from a motor vehicle manufacturer to a motor vehicle dealer or to the lessee of the vehicle which is used as a Capitalized Cost Reduction or otherwise applied to payments due under the lease is part of the sales price subject to tax in accordance with the provisions of Directive 97-4.

#### Issue 1(d):

How does Massachusetts sales or use tax apply to Capitalized Cost Reductions when a retail customer leases a motor vehicle from an out-of-state dealer and the dealer delivers the vehicle to the lessee in Massachusetts?

#### Directive 1(d):

When an out-of-state dealer delivers a vehicle to a lessee in Massachusetts, the dealer must collect and remit Massachusetts tax on Capitalized Cost Reductions in accordance with DD 97-4.

#### Issue 1(e):

How does sales or use tax apply to Capitalized Cost Reductions when a retail customer leases a motor vehicle from an out-of-state dealer for use, storage or consumption in Massachusetts, and the lessee takes possession of the vehicle outside of Massachusetts?

#### Directive 1(e):

A retail customer who leases a motor vehicle from an out-of-state dealer and takes possession of the vehicle outside of Massachusetts generally must pay sales tax as required by the jurisdiction where the sale takes place. However, when an out-of-state dealer leases a vehicle for use, storage or consumption in Massachusetts, and the lessee takes possession of the vehicle out-of-state, the dealer must collect and remit use tax to Massachusetts<sup>1</sup> on Capitalized Cost Reductions to the extent that the use tax exemption for tax paid under the laws of another state does not apply. See TIR 91-7. Without limitation, a vehicle is presumed to be leased for use, storage or con-

1. Subject to any applicable constitutional limitations. Cf. *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992).

sumption in Massachusetts if the address where the vehicle will be registered is in Massachusetts.

## **2. Other Charges Included in Vehicle Lease Payments: Extended Warranty/Service Contracts and Life, Accident or Health Insurance**

### **Issue 2(a):**

Is tax due on charges for optional extended warranty/service contracts or "roadside assistance" contracts sold by a dealer in Massachusetts at the time a motor vehicle lease is executed?

### **Directive 2(a):**

If charges for an optional extended warranty/service contract or "roadside assistance" contract are included in the lease payments and separately stated in a lease of one year or more, then that portion of the lease payment is not subject to tax. If the charges for the optional extended warranty/service contract or "roadside assistance" contract are included in the lease payments and not separately stated in the motor vehicle lease, then the lease payment is subject to tax in accordance with the provisions of 830 CMR 64H.25.1(9).

### **Issue 2(b):**

Is tax due on charges for optional life, accident or health insurance policies that are sold by a dealer in Massachusetts at the time a motor vehicle lease is executed?

### **Directive 2(b):**

If the cost of an optional life, accident or health insurance policy is included in the lease payments and is separately stated in a lease of one year or more, then that portion of the lease payment is not subject to tax. If the cost of the policy is included in the lease payments and not separately stated in the motor vehicle lease, then the lease payment is subject to tax in accordance with the provisions of 830 CMR 64H.25.1(9).

## **3. "Separately Stated" Charges**

### **Issue 3:**

For a charge to be considered "separately stated," must the separate statement be in the lease contract or on the monthly payment coupon or both?

### **Directive 3:**

Generally, the Department will consider charges for an item "separately stated" if the total cost for that individual item is stated in the lease contract as a distinct component of the total lease charges. A monthly payment coupon prepared by the lessor need not also break-down the amount due for that month into separate components. The amount of the monthly payment attributable to a separately stated charge in the lease is the total cost for that item as stated in the lease contract divided by the total number of months in the term of the lease.

## **4. Other Charges on Termination of Lease or Lessee's Default**

### **Issue 4(a):**

At the end of a lease term for a motor vehicle, are charges paid by the lessee for excess mileage, excess wear and tear, reconditioning, early termination of the lease, or other similar charges subject to tax?

### **Directive 4(a):**

Charges paid by the lessee at termination of a motor vehicle lease for excess mileage, excess wear and tear, reconditioning, early termination of the lease, or other similar charges are included in the sales price upon which tax is calculated for that period.

### **Issue 4(b):**

If the lessee of a motor vehicle defaults on its lease obligations, the lessor may incur legal or other expenses in connection with the repossession of the vehicle. Are charges for such expenses subject to tax when recovered from the lessee?

### **Directive 4(b):**

Legal expenses or other costs incurred by a motor vehicle lessor in connection with repossession following the lessee's default are not lease or rental charges subject to tax when they are recovered from the lessee.

### **Issue 4(c):**

What are the sales tax consequences when the lessee of a motor vehicle fails to make monthly payments or otherwise defaults on his or her obligations under the lease?

### **Directive 4(c):**

For sales tax purposes, a motor vehicle lessor must report lease payments on an accrual rather than a cash basis. If tax is remitted on accounts later determined to be worthless and written off as bad debts, the lessor may file a claim for reimbursement of tax paid on such amounts in accordance with TIR 92-2.

### **Issue 4(d):**

What are the sales tax consequences of a lessor applying a security deposit to past due lease payments, charges on termination of a lease, and legal or other costs incurred in connection with repossession following the lessee's default?

### **Directive 4(d):**

A security deposit is not subject to tax when paid by a lessee to a lessor of a motor vehicle. However, absent explicit agreement in the written lease to the contrary, the Department will consider security deposits retained by the lessor to be applied to the lessee's obligations in the following order (1) outstanding lease payments, (2) termination charges and (3) legal expenses or other costs incurred by the lessor in connection with repossession. Security deposits so applied are subject to tax in accordance with Directives 4(a) and 4(b), above.

**Discussion of Law:**

Massachusetts imposes an excise upon all retail sales of tangible personal property and telecommunications services in Massachusetts by a vendor unless otherwise exempt. The definition of sale includes any transfer of title or possession, or both, for a consideration including leases or rentals of tangible personal property. Where applicable, the excise is imposed at the rate of five percent of the sales price of the property or services sold. G.L. c. 64H, §§ 1,2. A complementary five percent use tax is imposed on tangible personal property and telecommunications services purchased from any vendor for storage, use or consumption in Massachusetts. G.L. 64I, §§ 1,2.

Where the transfer of title or possession of a motor vehicle takes place outside of Massachusetts and the vehicle is thereafter stored, used or otherwise consumed in Massachusetts, use tax may be due. A vehicle is presumed to have been sold or transferred for storage, use, or other consumption in Massachusetts, unless the vehicle is use exclusively outside of Massachusetts for a period of six (6) months before the date it is first delivered, brought into, or used in Massachusetts. See 830 CMR 64H.25.1(3).

The sales price on which tax is calculated is generally the total amount paid by a purchaser to a vendor as consideration for a retail sale, valued in money or otherwise. G.L. c. 64H, § 1. In sales of motor vehicles involving a trade-in of another vehicle, the sales tax is computed on the sales price reduced by any amount credited towards the sales price by reason of a trade-in if the sale is being made by a Massachusetts dealer in the regular course of business and the purchaser either previously paid a tax on the vehicle traded-in or was exempt from tax on the vehicle traded-in. See G.L. c. 64H, § 26 and 830 CMR 64H.25.1(5)(c). If a vendor sells tangible personal property to a retail purchaser who will receive a rebate from the manufacturer, the sales price subject to tax is the full purchase price of the property and is not reduced by the amount of the rebate. See 830 CMR 64H.1.4(3).

Unlike vendors of other types of tangible personal property, motor vehicle dealers are generally precluded from collecting sales tax from the retail customer; the tax is instead paid by the retail customer to the Registrar of Motor Vehicles. G.L. c. 64H, § 3(c). However, the Supreme Judicial Court has ruled that G.L. c. 64H, § 3(c) is not applicable to lease transactions and that a lessor must collect and remit tax due on such sales. See *Baker Transport v. State Tax Commission*, 371 Mass. 872, 360 N.E. 2d 860 (1977) and LR 82-47.

Each period for which a motor vehicle lease or rental payment is charged is considered a completed retail sale for the purpose of imposition, collection, and payment of sales tax. The sales price on which the tax is computed for each period is the total lease or rental charges for that period. However, if the lease is for a period of one year or more, and if the monthly lease payments include separately stated charges for fuel, insurance, motor vehicle excise or registration fees, then the charges for those items are not included in the sale price on which the tax is computed. See 830 CMR 64H.25.1(9) for rules for computation of tax when such charges are included in monthly lease payments but not separately stated.

A vendor generally must report sales on an accrual rather than a cash basis for sales tax purposes. *Continental-Hyannis Furniture Company, Inc. v. State Tax Commission*, 318 N.E. 2d 618 (1974). A vendor may apply to the Department for reimbursement of tax remitted on accounts later determined to be worthless and written off as bad debts. G.L. c. 64H, § 33. See TIR 92-2.



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